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PEREGRINE PETROLEUM LTD.



**1988
ANNUAL REPORT**

Corporate Information

OFFICERS AND DIRECTORS:

Cameron J. McFeely, P.Eng.

President and Director

Theresa L. Parsons

Secretary and Director

Rodger A. Tourigny

Director

Peter G. Smith

Director

HEAD OFFICE:

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TRANSFER AGENT:

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411 - 8th Avenue S.W.

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AUDITORS:

Coopers & Lybrand

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STOCK EXCHANGE LISTING:

The Alberta Stock Exchange

Letter to Shareholders

Peregrine's major asset is its approximately 30% shareholding in Mosquito Consolidated Gold Mines Limited (Mosquito). Last year Mosquito entered into an agreement with Lyon Lake Mines Ltd., whereby Lyon Lake could earn a 50% undivided interest in the Mosquito and Island Mountain project at Wells, B.C. by the expenditure of \$6 million in exploration. During 1988, Lyon Lake expended the \$6 million on an exploration program and are now 50% joint venture partners with Mosquito.

The program for 1988 was devoted principally to accessing the ore-bearing limestone members (the "Aurum" and "Main Band" limestones) by means of two exploration adits, the "Jukes" and "Island Mountain" adits. Now, the program for 1989 will concentrate on ore search by drilling and drifting in these two members.

An ore search program of \$2.9 million has been proposed and Mosquito is currently arranging financing for its 50% share. The objective of this program is as before – to explore for and prove up sufficient ore to reopen the mill in 1989.

Also during 1988 Mosquito entered into an agreement with Pan Orvana Resources Inc. whereby Pan Orvana could earn an undivided 50% interest in Mosquito's "Cariboo" property at Wells, B.C. by

incurring \$2 million of exploration expenditures. This exploration program is directed solely towards the possibility of developing a bulk tonnage operation on this property. Pan Orvana has completed the first year's work program and has proposed a follow-up program of trenching and drilling in 1989.

In summary, in the coming year the properties held by Mosquito will be exposed to a very active program of exploration and ore search, culminating, we hope, in the re-opening of the Mosquito mill.

Submitted on behalf of the Board,



C.J. McFeely, P.Eng.
President

January 29, 1989

Consolidated Balance Sheet

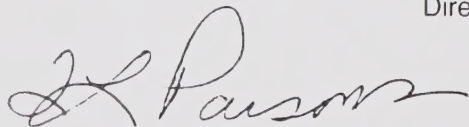
as at September 30, 1988

	1988 \$	1987 \$
ASSETS		
CURRENT ASSETS		
Cash	22,293	166,291
Accounts receivable	75,512	117,703
Prepaid expenses	2,147	1,353
Marketable securities — quoted market value — \$5,416		
(1987 — \$16,800)	5,357	2,464
Due from related parties	30,428	7,500
	135,737	295,311
PROPERTY AND EQUIPMENT — at cost less accumulated depreciation and depletion (note 3)	622,328	667,609
INVESTMENT IN SIGNIFICANTLY INFLUENCED COMPANY (note 4)	1,602,246	1,169,732
OTHER ASSETS — at cost	88,218	96,501
	<u>2,448,529</u>	<u>2,229,153</u>

SIGNED ON BEHALF OF THE BOARD



Director



Director

	1988	1987
	\$	\$
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	103,004	91,093
Advances from a shareholder (note 8)	68,682	188,974
Current portion of bank loan (note 5)	970,000	1,036,000
	1,141,686	1,316,067
DEBENTURE PAYABLE TO A SHAREHOLDER (note 6)	1,527,706	1,512,522
GAS PRODUCTION PREPAYMENT	22,076	24,768
	2,691,468	2,853,357

DEFICIT LESS CAPITAL STOCK

DEFICIT	5,455,307	5,814,042
CAPITAL STOCK (notes 6 and 7)	5,212,368	5,189,838
	(242,939)	(624,204)
	2,448,529	2,229,153

Consolidated Statement of Deficit

for the year ended September 30, 1988

	1988 \$	1987 \$
BALANCE — BEGINNING OF YEAR	5,814,042	5,505,024
Net earnings (loss) for the year	358,735	(309,018)
BALANCE — END OF YEAR	<u>5,455,307</u>	<u>5,814,042</u>

Consolidated Statement of Earnings

for the year ended September 30, 1988

	1988 \$	1987 \$
INCOME		
Oil and gas production — (including Alberta Royalty Tax Credit)	398,225	512,559
Interest	1,307	36,472
	<u>399,532</u>	<u>549,031</u>
EXPENSES		
Production	133,051	154,563
General and administrative	96,881	93,140
Interest — long-term debt	131,373	174,028
Lease rentals	4,468	7,016
Loss on foreign currency translation	2,450	1,021
	<u>368,223</u>	<u>429,768</u>
EARNINGS BEFORE THE FOLLOWING	<u>31,309</u>	<u>119,263</u>
OTHER INCOME (EXPENSES)		
Gain on decrease of share interest in significantly influenced company (note 4)	285,830	43,173
Equity in earnings (loss) of significantly influenced company	146,684	(94,019)
Depletion and depreciation	(65,640)	(69,930)
Dry holes, abandonments and write-downs	(34,773)	(386,382)
Gain (loss) on sale of oil and gas properties	(13,800)	36,838
Gain on sale of marketable securities	9,125	—
	<u>327,426</u>	<u>(470,320)</u>
EARNINGS (LOSS) BEFORE EXTRAORDINARY ITEM (note 7)	<u>358,735</u>	<u>(351,057)</u>
EXTRAORDINARY ITEM		
Gain on forgiveness of interest on shareholder debenture	—	42,039
NET EARNINGS (LOSS) FOR THE YEAR (note 7)	<u>358,735</u>	<u>(309,018)</u>

Consolidated Statement of Changes in Financial Position

for the year ended September 30, 1988

	1988 \$	1987 \$
OPERATING ACTIVITIES		
Net earnings (loss) for the year before extraordinary item	358,735	(351,057)
Items not affecting cash flow —		
Gain on decrease of share interest in significantly influenced company	(285,830)	(43,173)
Equity in loss (earnings) of significantly influenced company	(146,684)	94,019
Depletion and depreciation	65,640	69,930
Dry holes, abandonments and write-downs	34,773	386,382
Accrued interest on debenture payable to a shareholder	15,184	54,561
Loss (gain) on sale of oil and gas properties	13,800	(36,838)
Accrued interest income on debenture receivable for a related party	—	(33,599)
Decrease in deferred revenue	(2,692)	(2,890)
	<u>52,926</u>	<u>137,335</u>
Net change in non-cash working capital balances related to operations*	50,415	(34,610)
Cash provided from operating activities	<u>103,341</u>	<u>102,725</u>
FINANCING ACTIVITIES		
Decrease in advances from a shareholder	(120,292)	(113,910)
Decrease in bank loan	(66,000)	(66,000)
Decrease (increase) in advances to related parties	(22,928)	86,061
Proceeds from flow-through share subscription received, net of incentives	22,530	—
Decrease in debenture receivable from a related party	—	396,975
Cash provided from (used in) financing activities	<u>(186,690)</u>	<u>303,126</u>
INVESTING ACTIVITIES		
Additions to property and equipment, net of incentives	(74,182)	(45,705)
Decrease in (additions to) other assets	8,283	(71,890)
Proceeds on sale of oil and gas properties	5,250	36,838
Increase in investment in significantly influenced company on conversion of debenture receivable to common shares	—	(396,975)
Cash used for investing activities	<u>(60,649)</u>	<u>(477,732)</u>
DECREASE IN CASH	<u>(143,998)</u>	<u>(71,881)</u>
CASH — BEGINNING OF YEAR	<u>166,291</u>	<u>238,172</u>
CASH — END OF YEAR	<u>22,293</u>	<u>166,291</u>

* Consisting of changes in accounts receivable, prepaid expenses, marketable securities and accounts payable and accrued liabilities.

Notes to Consolidated Financial Statements

for the year ended September 30, 1988

1. BASIS OF PRESENTATION

The continued operation of the company as a going concern is dependent upon the ability of the company to obtain necessary financing to continue exploration and development activity and upon future profitable production. As a result, the company is dependent upon its major shareholder for financial support of operations and advances for capital expenditures.

2. ACCOUNTING POLICIES

Principles of consolidation

The consolidated financial statements include the accounts of Peregrine Petroleum Ltd. and its wholly-owned subsidiary, Peregrine Petroleum Inc.

Investment in significantly influenced company

The investment in Mosquito Consolidated Gold Mines Limited (formerly The Mosquito Creek Gold Mining Company Limited) is accounted for by the equity method, by which the original cost of the shares is adjusted for the company's proportionate share of earnings or losses less dividends received and any capital transactions in shares of the investee, since significant influence was acquired.

Petroleum and natural gas properties

The company's accounting policy is to capitalize acquisition costs attributed to petroleum and natural gas properties. When properties are surrendered, the costs are written off as an expense in the year of abandonment. Lease rentals are expensed when incurred. Costs of drilling and equipping successful exploratory and development wells, net of government incentives, are capitalized. Gains or losses on dispositions of petroleum and natural gas properties are included in income and the costs of dry holes and abandonments are expensed.

Depletion and depreciation of the acquisition, exploration and development costs of producing properties and production equipment are calculated using the unit-of-production method, based upon proven recoverable reserves.

Joint ventures

Substantially all of the company's exploration and production activities are conducted jointly with others and the accounts reflect only the company's proportionate interest in such activities.

Translation of foreign currencies

Accounts maintained in foreign currencies have been translated into Canadian funds on the following basis: monetary assets and liabilities at the rate of exchange in effect at the year-end; non-monetary assets at the rate at the time of acquisition, and revenues and expenses at the average rates for the year except for depreciation and depletion which are translated at the same rates as used for the related assets. Gains or losses from the translation of the accounts maintained in foreign currencies are reflected in the statement of earnings.

3. PROPERTY AND EQUIPMENT

	1988			1987
	Cost	Accumulated depreciation and depletion	Net book value	Net book value
	\$	\$	\$	\$
Petroleum and natural gas —				
Properties	1,015,218	579,778	435,440	487,532
Production equipment	352,215	189,637	162,578	169,785
	1,367,433	769,415	598,018	657,317
Office equipment	73,907	49,597	24,310	10,292
	<u>1,441,340</u>	<u>819,012</u>	<u>622,328</u>	<u>667,609</u>

4. INVESTMENT IN AND SIGNIFICANT TRANSACTIONS AFFECTING SIGNIFICANTLY INFLUENCED COMPANY

On December 4, 1987, The Mosquito Creek Gold Mining Company Limited consolidated its outstanding shares at a ratio of 5 to 1. The name of the company was changed from The Mosquito Creek Gold Mining Company Limited to Mosquito Consolidated Gold Mines Limited (Mosquito). Mosquito's principal assets consist of gold mining properties, presently being explored near Wells, in east-central British Columbia.

During the year, Mosquito finalized an agreement with Lyon Lake Mines Ltd. (N.P.L.) (Lyon), effective March 4, 1988, whereby Mosquito agreed to grant Lyon the right to earn an undivided interest in up to 50% in certain of Mosquito's mining properties by incurring up to \$6,000,000 of exploration expenditures on the properties prior to February 28, 1989. Lyon will earn a 20% working interest in the properties for the first \$2,400,000 of expenditures made and an additional 10% for each \$1,200,000 of expenditures made thereafter. Mosquito will carry on as an independent contractor on behalf of Lyon throughout the expenditure period, earning an administration fee of 10% on all direct non-contract costs and 5% on all direct contract costs as well as a management fee of 12% on all direct costs. As at September 30, 1988, Lyon had incurred \$3,100,000 of expenditures on the project and Mosquito had earned \$662,000 of management and administration fee income.

During the year, Mosquito finalized an agreement with Pan Orvana Resources Inc. (Orvana) whereby Mosquito agreed to grant Orvana the right to earn an undivided 50% interest in Mosquito's Cariboo Gold Quartz property by incurring \$2,000,000 of exploration and development expenditures on the property prior to May 30, 1993.

During the year, the company's interest in Mosquito was decreased from 37.8% to 30.21% as a result of the following capital transactions:

- 193,333 shares were issued by Mosquito for a cash consideration of \$193,333 on conversion of certain share purchase warrants;
- 736,459 shares were issued by Mosquito pursuant to two flow-through share agreements entered into during the year after \$1,487,000 had been expended exploring Mosquito's mineral properties;
- 72,000 shares with an attributed value of \$90,000 were issued by Mosquito in consideration of services rendered in arranging the meeting between Mosquito's president and the president of Lyon.

The effect of these transactions is to reduce the company's ownership in Mosquito and results in a net gain to the company of \$285,830 which represents the company's share of the increase in equity of Mosquito's net assets as a result of the share issuances.

5. BANK LOAN

	1988 \$	1987 \$
Demand loan bearing interest at 11½% over prime rate (11¾% at September 30, 1988).....	660,000	660,000
Demand loan bearing interest at 11½% over prime rate (11¾% at September 30, 1988).....	310,000	376,000
	970,000	1,036,000
Less: Current portion	(970,000)	(1,036,000)
	<u>—</u>	<u>—</u>

The agreement with the bank relating to repayment terms for both loans has expired. The bank has advised the company that the terms of the expired agreement relating to the demand loan for \$660,000 have not been met and that this contravenes the events of default clause under that agreement. The loans are being classified as a current obligation until repayment terms have been determined.

Book debts, production proceeds from certain petroleum and natural gas properties and 400,000 shares in Mosquito Consolidated Gold Mines Limited have been pledged as security for the bank loans.

6. DEBENTURE PAYABLE TO A SHAREHOLDER

On December 22, 1982, the company issued a \$1,500,000 debenture securing cash advanced by its major shareholder. The debenture bears interest at a rate of 1% per annum and is convertible into common shares of the company at the rate of 1 common share for each \$.15 of principal and interest outstanding. Although the debenture and accrued interest are subject to call on demand, the shareholder has agreed not to demand payment within the next twelve months.

7. CAPITAL STOCK AND EARNINGS PER SHARE

(a) During the year, pursuant to a special resolution of the shareholders, the company increased the authorized number of common shares from 10,000,000 shares to an unlimited number of shares.

(b) Authorized —
Unlimited number of common shares without
nominal or par value

	1988 \$	1987 \$
Issued and fully paid — 6,207,355 shares	5,189,838	5,189,838
Earned but not issued — 259,832 shares (1987 - nil)	22,530	—
	<u>5,212,368</u>	<u>5,189,838</u>

(c) Flow-through shares

During the year, the company entered into a flow-through share agreement with its president and major shareholder. Under the terms of the agreement, up to \$200,000 of monies received by the company prior to December 31, 1988 shall be spent on behalf of the subscriber in exploring for and developing the company's petroleum and natural gas properties. Shares will be earned as the monies are spent on qualifying expenditures at the rate of one share for every \$.13 of expenditures made. At September 30, 1988, \$33,778 had been expended pursuant to the terms of this agreement.

7. CAPITAL STOCK AND EARNINGS PER SHARE (continued)

All grants receivable under government incentive programs and income tax deductions available as a result of these expenditures are for the account of the subscriber while the company retains title to the petroleum and natural gas properties and related reserves. As a result of the flow-through to the subscribers of the incentive payments and income tax benefits, the amount at which the shares will be issued is less than the amount of funds initially subscribed and expended.

(d) Employee stock options

Under the company's stock option plan, 200,000 shares are reserved to provide options to its employees to purchase shares of the company. As at September 30, 1988, options to purchase 50,000 shares, exercisable up to September 3, 1992 at a price of \$.20 per share have been granted and were outstanding.

(e) Earnings per share

	1988 \$	1987 \$
Basic earnings (loss) per share		
Before extraordinary item.....	<u>.06</u>	<u>(.06)</u>
Net earnings (loss) for the year	<u>.06</u>	<u>(.05)</u>
Fully diluted earnings (loss) per share		
Before extraordinary item.....	<u>.02</u>	<u>(.06)</u>
Net earnings (loss) for the year	<u>.02</u>	<u>(.05)</u>

8. RELATED PARTY TRANSACTIONS

The company's major shareholder and president is the major shareholder and president of Camac Explorations Inc. (Camac) and Cormorant Resources Ltd. (Cormorant), and is also the president of Mosquito Consolidated Gold Mines Limited (Mosquito), a publicly traded company in which the company has 30.21% of the shares.

The balance owing from Camac at September 30, 1988, is nil (1987 - \$7,500). The company received \$5,088 (1987 - \$7,500) as compensation for management services to Camac for the year.

The company participates with Cormorant in the exploration and development of petroleum and natural gas properties. During the year, the company expended \$32,423 (1987 - \$9,322) on petroleum and natural gas properties in which Cormorant has an interest. The company received \$42,000 (1987 - \$42,000) as compensation for management services to Cormorant for the year.

The advances from the company's president and major shareholder of \$68,682 (1987 - \$188,974) are non-interest bearing and have no fixed terms of repayment.

During the year, the company received \$110,000 (1987 - \$60,000) from Mosquito as compensation for management services. The balance owing from Mosquito included in due from related parties, at September 30, 1988 is \$30,428 (1987 - nil).

9. INCOME TAXES

There is no provision for income taxes on the net earnings for the year of \$359,600, as a result of excluding from income taxes the gain on decrease of share interest in significantly influenced company and the equity in earnings of significantly influenced company totalling \$432,514.

9. INCOME TAXES (continued)

The company has exploration and development expenditures of \$241,000, foreign exploration and development expenditures of \$1,600,000 and undepreciated capital cost of \$850,000 which may be carried forward indefinitely and utilized to reduce future Canadian taxable income. These amounts totalling \$2,691,000 are in excess of the net book value of the related assets of \$622,328. No future tax benefit relating to the excess of \$2,068,672 has been recognized in the accounts.

In addition, the company has accumulated losses for tax purposes of \$283,000 which may be carried forward and used to reduce taxable income in future years and for which no future tax benefit has been recognized in the accounts. These losses may be claimed no later than 1994 - \$106,000 and 1995 - \$177,000.

10. SEGMENTED INFORMATION

The company's dominant industry segment is the exploration and development of petroleum and natural gas properties in Canada.

Auditors' Report to the Shareholders

We have examined the consolidated balance sheet of Peregrine Petroleum Ltd. as at September 30, 1988 and the consolidated statements of earnings, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at September 30, 1988 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Coopers & Lybrand

Chartered Accountants

Calgary, Alberta
November 29, 1988

